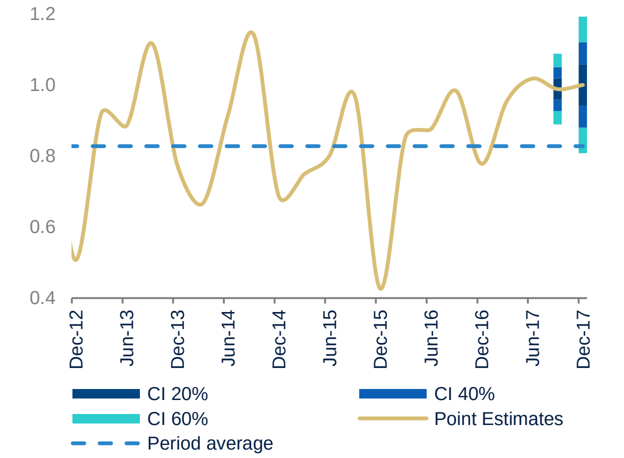
2. The positive global environment is strengthening

Robust and steady global growth with a more synchronized recovery across areas

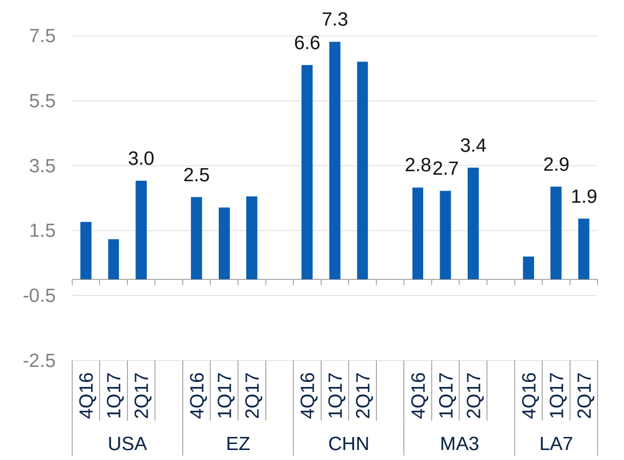
The growth rate of the world economy has stabilised by mid-year at around 1% QoQ, and the available indicators suggest so far that this trend will continue in the second half of the year (Figure 2.1). **Global confidence indicators continue to improve**, both in advanced and emerging economies, and anticipate a more positive outlook than the activity indicators, which slowed down at the beginning of the third quarter. Nonetheless, **global trade growth remains solid and the recovery of the industrial sector continues apace**, underpinning the upturn in investment, while private consumption remains resilient despite weaker tailwinds.

Figure 2.1. World GDP growth (QoQ, %) Forecasts based on BBVA-GAIN



Source: BBVA Research

Figure 2.2. GDP growth by region (Seasonally Adjusted Annual Rate, %)



Source: BBVA Research

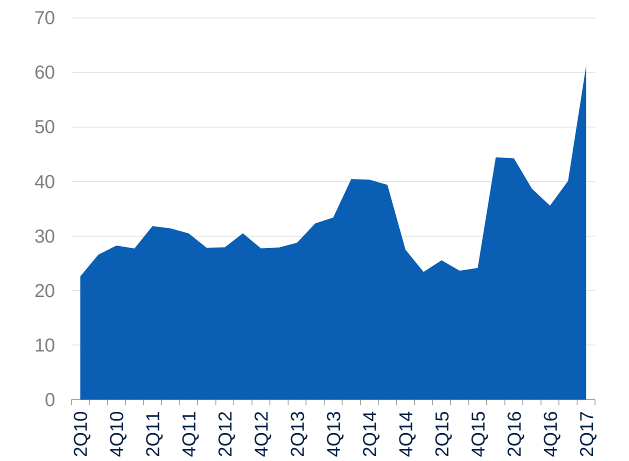
This positive dynamic reflects a stronger economic performance in all areas (Figure 2.2). In the advanced economies, US GDP rebounded in Q2 and dispelled doubts over the persistence of moderate growth in the coming quarters, while a greater strength from domestic factors was behind the positive surprise in Europe. In emerging economies, stable growth in China will continue to support the rest of Asia, which, coupled with favourable financial markets conditions, is also allowing growth in Latam countries to gain traction. In addition, the recovery in Russia and Brazil means that these countries are no longer dragging global growth. Hence, unlike other episodes of growth since the financial crisis (in early 2013 and mid 2014), the current recovery is proving to be more synchronised[1], according to our index[2].

1: Proof of this can be found in the fact that Harding and Pagan's concordance index for growth in developed and emerging economies has risen 25% since 2016.
2: The synchronisation index given here is the product of inverting the standard deviation of quarterly growth observed across countries. The index therefore associates less (more) growth volatility among countries with a higher (lower) degree of synchronisation worldwide.

This environment of positive and more synchronised growth has thus far been accompanied by **moderate levels of inflation**, also generalized by areas, despite the abundance of liquidity in the markets, while there are still no clear signs of accumulation of inflationary pressures. In the case of the emerging markets (EM), the appreciation of their currencies due to a weak dollar and a certain increase in commodity prices has helped inflation to continue to abate. Among the developed economies, the reduction in inflation results from the disappearance of the base effect of energy prices (especially in Europe) and certain transitory factors (mainly in the United States), although **core inflation remains at low levels** and doubts persist on whether the factors underlying this weakness of inflation are temporary or permanent. This context helps **central banks in the emerging economies to have greater room for manoeuvre to continue supporting** growth, **while it allows the monetary authorities in the advanced economies to remain cautious in normalizing their monetary policies**.

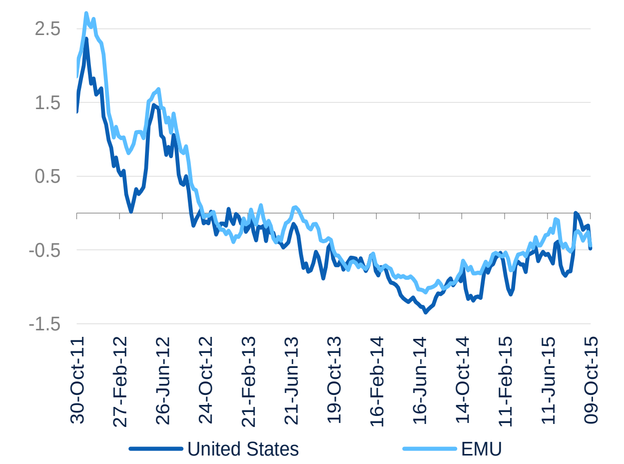
Other drivers behind the global performance, such as **fiscal policies, have generally been neutral or expansionary lately,** while relatively subdued commodity prices appear to extend over the forecast horizon, and **relatively complacent financial markets** are not suffering persistently from sources of political stress.

Figure 2.3. Synchronisation index (based on the time variance of GDP)



Source: BBVA Research

Figure 2.4. Financial tension index. USA vs. Eurozone (normalised)



Source: BBVA Research

Favourable environment in financial markets and normalization of monetary policies

In this quarter **market dynamics have been broadly unchanged since the first half of the year in spite of episodes of stress** (Figure 2.4), above all of a political (debt ceiling debate in the United States) and geo-political nature (tensions in North Korea). These events have caused a certain safe-haven effect on debt, which has led long-term interest rates to the lower end of the market range. However, its effect has been only transitory.

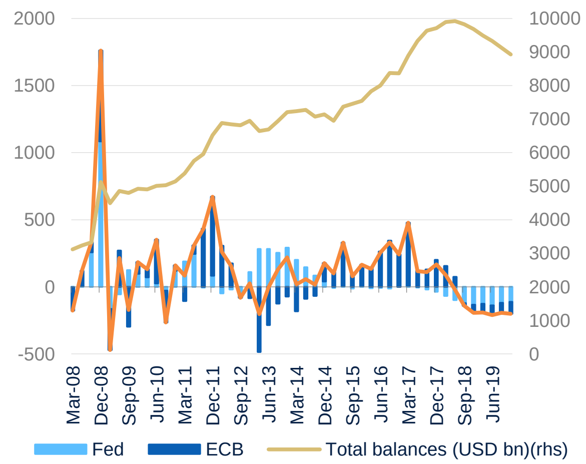
In an environment where growth remains dynamic and with no downward surprises on inflation, **central banks are pressing ahead with the gradual process of withdrawing monetary stimulus**. Specifically, the **US Federal Reserve**

(Fed) has announced it will start reducing its balance sheet as from October. This would take the form of a passive reduction, by allowing a portion of public and private bonds to expire, which has been well communicated, so it has not generated any tensions in markets. Moreover, the Fed, still expects to implement a series of rate hikes, even though the markets have systematically shown themselves to be more bearish. **We expect a 25 bp hike for official rates in December this year and then two further hikes up to 2% in 2018**. However, uncertainty about these hikes has increased, not only because inflation is still at low levels, but also **because of the changes that are going to take place at the Fed** following the exit of many of its members, including the vice chair, and with the uncertainty on whether its Chair will remain in office.

The European Central Bank **(ECB) will announce the tapering of its asset purchase programme in October**, which it would start to implement in January next year. The withdrawal of stimulus will be gradual and the ECB will be as flexible as possible, although the precise strategy it will adopt is uncertain as regards how much it will scale back its purchases and for how long the programme will continue. Our scenario contemplates a gradual reduction in purchases until the programme ends in summer 2018. **Rate hikes, however, will be delayed until mid 2019,** largely due to the ECB's growing concern over euro appreciation and its potential impact on inflation.

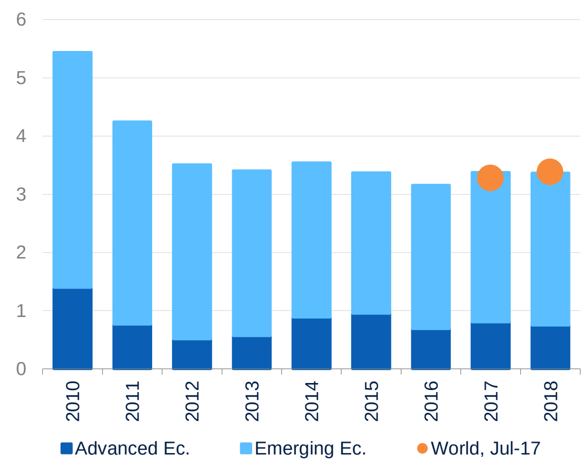
Like in the previous quarter, the combination of low volatility, low rates and dollar weakness have drawn a favourable outlook for EMs. Hunt for yield **strategies have led to strong inflows towards EMs**, particularly in the bond market, as well as currency strength.

Figure 2.5. Fed and ECB balance sheets
(level and quarterly changes, in billions of USD)



Source: BBVA Research

Figure 2.6. World GDP forecast by region
(% YoY)



Source: IMF and BBVA Research

Higher global growth on the upward revision in Europe and China

Our **new forecasts lead global growth to accelerate to 3.4% in 2017-18** (Figure 2.6), which implies an upward revision of around 0.2pp this year and an acceleration from 3.2% in 2016. This change is due to **higher forecasted growth both for China and Europe in 2017** on account of positive surprises in both regions since Q2. For the United States, we are maintaining our estimate of sustained growth of slightly over 2% within the forecast horizon, while the better progress predicted for the Latam economies is being confirmed. In contrast, growth for the rest of the Asian economies will continue to be robust, although it will feel the effect of the expected slowdown in the Chinese economy in the coming quarters.

The underlying factors supporting the acceleration and stability of global growth will remain present, even though some of them could gradually wear off in the coming quarters. The most immediate will be the normalisation of monetary policy by both the Federal Reserve and the European Central Bank (Figure 2.5), as it will lead to gradual reduction in global liquidity and less support for capital flows into the emerging economies. In addition, **there are still multiple political risks that can influence economic confidence and market behaviour.**

The U.S.: sustained growth in spite of political uncertainty and natural disasters

GDP growth **rebounded to 3.1% YoY in Q3**, **bouncing back from the substantial decline experience din the two previous quarters.** Although uncertainty is still high, due to both natural disasters and economic policy, the **economic fundamentals remain consistent with sustained growth of around 2%** which has been recorded over the past two and a half years. The **net economic impact of the hurricanes will be limited at the national level**, given that the 0.2pp that we estimate could be subtracted from growth in Q3 should be offset by the reconstruction efforts in the final stretch of the year. Moreover, the agreement between the government and the Democrats has delayed **the deadline for approving the budget** (guaranteeing government funding until December) **and raised the debt ceiling**. With respect to economic policy, the government is now focusing on **tax reform, but this is still short on essential details** and offers only limited options for enhancing efficiency. Even if it is finally approved**, the tax cuts are unlikely to give a significant boost to economic growth** given the cyclical situation of the economy, which is very close to full employment.

For all these reasons **we maintain our GDP growth forecast of 2.1% in 2017 and 2.2% in 2018**. The solidity of global growth, dollar depreciation, expectations of sustainable oil prices and the mild improvement in construction should support **an upturn in investment.** On the contrary, the more gradual improvement in the labour market and higher inflation lead us to continue to forecast **a slowing down in private consumption** over the forecast horizon. Even so, more sluggish growth in prices in recent months and the absence of any clear signs of inflationary pressures mean that we expect the **Fed to continue slowly with its normalisation process** for monetary policy. The risks for this scenario are still to the downside owing to the unknowns regarding the implementation of the economic policy measures announced, whereas the long period of cyclical expansion together with lax demand-side policies still work in favour of a build-up of financial vulnerabilities that could trigger a recession in the medium term.

China: a more promising outlook in the short term

Support from the Chinese authorities, especially with a pro-growth fiscal policy, has led to **a somewhat better than expected economic performance in the first half of the year**, with GDP growth stabilising at 6.9% YoY. In spite of this, **measures have been taken over the year to tackle financial vulnerabilities and encourage an orderly deleveraging process.** Particularly, the tightening of regulation on shadow banking and real estate markets are being combined with more prudent monetary policy, less expansionary fiscal policy and the removal of certain controls from the exchange market. The Communist Party Congress in mid October should shed more light on both the commitment on the part of the authorities to taking on the expected structural reforms to adjust the growth pattern and whether priority will be given to financial stability over economic growth.

As a result of the recent improved performance, we have **revised up our GDP growth forecast upwards by around 0.2pp to 6.7% in 2017**, somewhat higher than the target of 6.5% that the authorities are aiming for, **although we maintain our prediction of a slowdown in 2018 to 6%**. Since mid-year available indicators were already showing us signs of more moderate economic growth and could be reflecting the impact of more prudent demand-side policies, but with the adverse effect on activity of regulatory tightening, the removal of over-capacity from companies and currency appreciation. Inflation remains subdued, especially in food, although industrial product prices have risen again due to supply-side disruptions. In contrast, the regulatory toughening and a stronger currency should continue to contain price developments, and thus we **are keeping our inflation forecast at 1.7% in 2017 and 2% in 2018**.

The authorities' strategy and the more gradual slowdown in growth have **diminished the risks over the forecast horizon, although they are still rising over the medium term** given that debt remains on the rise with some debt service indicators at high levels, while the adjustments by state-owned companies is still being delayed.

Eurozone: increased growth due to strong domestic demand

The **European economy** has advanced at a quarterly rate of **around 0.6% since the end of last year.** More sustained global demand continues to support exports, while the impact of a stronger euro has been limited. The strength of the euro partly reflects the best cyclical momentum **of the European economy, driven by the solidity of domestic fundamentals** (improvement in the labour market and increased confidence), which have encouraged a better performance by both consumption and investment. Although economic performance has been somewhat better than expected so far this year, the weakness of core inflation is keeping the ECB wary. Therefore, even if it will begin to reduce the bond purchasing programme at the beginning of next year, monetary policy will still underpin growth through the maintenance of very low interest rates beyond the forecast horizon. Fiscal policy will also be mildly expansionary in 2017-18, being favoured by the positive impact of the cyclical recovery, which provides more room for the Member States to maintain a degree of fiscal support without compromising the achievement of targets. For all these reasons **we have revised forecast GDP upwards by 0.2pp in 2017 to 2.2%**, which represents above-potential growth for the third year in a row. This makes it hard to imagine a significantly higher acceleration in the short term. In addition, **certain tailwinds from the past are faltering somewhat** or starting to blow in the opposite direction (euro appreciation, rising oil prices and the stabilisation of world growth) **and are behind the expected slowdown to 1.8% in 2018**.

Headline inflation has held relatively stable in the third quarter, with lower energy and food prices being offset by a rise of around 0.1pp in core inflation (to 1.3%). Beyond the volatility and seasonality of certain components of inflation, the strength of domestic demand, the improvement in the labour market and the incipient rise in wages should start to push prices upwards in the coming quarters, although **the impact of recent euro appreciation on import prices leads us to revise our forecast for headline inflation downwards** by around 0.1pp in 2017 to 1.5% and 0.2pp in 2018 to 1.2%, while we **are keeping an unchanged forecast of a gradual increase in core inflation** (1.1% this year and 1.4% in 2018).

Domestic risks for the Eurozone as a whole still have a downward bias but are moderate. And most of them are political, such as the obstacles in the Brexit negotiations, despite some recent rapprochement of the positions, the unresolved banking problems in certain countries, as well as the political tensions in certain Member States and the possible lack of support for moving ahead with the European project after the results of the German elections.

BBVA | Research

DISCLAIMER

This document, prepared by BBVA Research Department, is informative in nature and contains data, opinions or estimates as at the date of its publication. These derive from the department's own research or are based on sources believed to be reliable, and have not been independently verified by BBVA. BBVA therefore makes no guarantee, express or implied, as to the document's accuracy, completeness or correctness.

Any estimates contained in this document have been made in accordance with generally accepted methods and are to be taken as such, i.e. as forecasts or projections. The historical evolution of economic variables (positive or negative) is no guarantee that they will evolve in the same way in the future.

The contents of this document are subject to change without prior notice for reasons of, for example, economic context or market fluctuations. BBVA does not give any undertaking to update any of the content or communicate such changes.

BBVA assumes no responsibility for any loss, direct or indirect, that may result from the use of this document or its contents.

Neither this document nor its contents constitute an offer, invitation or solicitation to acquire, divest or obtain any interest in assets or financial instruments, nor can they form the basis of any contract, commitment or decision of any kind.

In particular as regards investment in financial assets that may be related to the economic variables referred to in this document, readers should note that in no case should investment decisions be made based on the contents of this document; and that any persons or entities which may potentially offer them investment products are legally obliged to provide all the information they need to take these decisions.

This report has been produced by the Argentina Unit

Head Economist Argentina
Gloria Sorensen
gsorensen@bbva.com

Marcos Dal Bianco
marcos.dalbianco@bbva.com

Juan Manuel Manias
juan.manias@bbva.com

María Celeste González
celeste.gonzalez@bbva.com

Andrea Savignone
asavignone@bbva.com

Adriana Haring
aharing@bbva.com

Jorge Lamela
jorge.lamela@bbva.com

BBVA Research

Group Chief Economist
Jorge Sicilia Serrano

Macroeconomic Analysis
Rafael Doménech
r.domenech@bbva.com

Global Economic Situations
Miguel Jiménez
mjimenezg@bbva.com

Global Financial Markets
Sonsoles Castillo
s.castillo@bbva.com

Long term Global Modelling and Analysis
J. Julián Cubero
juan.cubero@bbva.com

Innovation and Processes
Oscar de las Peñas
oscar.delaspenas@bbva.com

Financial Systems And Regulation
Santiago Fernández de Lis
sfernandezdelis@bbva.com

International Coordination
Olga Cerqueira
olga.gouveia@bbva.com

Digital Regulation
Álvaro Martín
alvaro.martin@bbva.com

Regulation
María Abascal
maria.abascal@bbva.com

Financial Systems
Ana Rubio
arubiog@bbva.com

Financial Inclusion
David Tuesta
david.tuesta@bbva.com

Spain and Portugal
Miguel Cardoso
miguel.cardoso@bbva.com

United States
Nathaniel Karp
Nathaniel.Karp@bbva.com

Mexico
Carlos Serrano
carlos.serranoh@bbva.com

Middle East. Asia and Geopolitical
Álvaro Ortiz
Alvaro.ortiz@bbva.com

Turkey
Álvaro Ortiz
alvaro.ortiz@bbva.com

Asia
Le Xia
le.xia@bbva.com

South America
Juan Manuel Ruiz
juan.ruiz@bbva.com

Argentina
Gloria Sorensen
gsorensen@bbva.com

Chile
Jorge Selaive
jselaive@bbva.com

Colombia
Juana Téllez
juana.tellez@bbva.com

Peru
Hugo Perea
hperea@bbva.com

Venezuela
Julio Pineda
juliocesar.pineda@bbva.com

CONTACT DETAILS: BBVA Research – BBVA Banco Francés: Reconquista 199, 1st floor. C1003ABC - Buenos Aires (Argentina).
Tel.: (+54) 11 4346 4000 / Fax: (+54) 11 4346 4416 - bbvaresearch@bbva.com www.bbvaresearch.com